INTEGRATED SUPERVISION OF CAPITAL MARKETS

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On April 1, 2000, an integrated governmental authority commenced its supervisory activities in the financial services sector pursuant to Section 12 of Act CXXIV of 1999 on Supervision of Financial Institutions.

From an investment protection standpoint, such integrated supervision has been a long-awaited response by the applicable state bodies in the faces of challenges of rapidly developing financial services market. Financial instruments and resources, i.e. securities, savings accounts and insurance investments, have become interchangeable to a large extent as compared to previous decades. Consequently, the providers of such services have entered each other's market, which has evolved into a merger-wave between the various financial entities.

In spite of the strict restrictions on acquiring stakes in credit institutions as per Section 37 to 44 of Act CXII of 1997 on Credit Institutions and Financial Undertakings ("Credit Institutions Act"), the concentration of the Hungarian capital market and recent EU-legislation required the implementation of *consolidated supervision* methods. Accordingly, Sections 90 to 96 of the Credit Institutions Act established the consolidated supervision of *banking groups*, the capital adequacy of which shall be calculated by adding the capital reserves, or the portion of the capital that corresponds to the stake or voting rights held in that company, assets of the bank, its controlled financial institutions and any affiliated undertakings.

Consolidated supervision is better suited for controlling the credit risks and large exposures risk naturally attributed to the banking sector. However, such concept cannot be put into practice unless a proper institutional system is established. Until recently, the responsible supervision bodies of the financial market participants was carried out by functionally separate institutions in Hungary, e.g. by the State Capital Market Supervision and the State Insurance Supervision. These so-called decentralized authorities made the supervision of single market participants effective, however, they could not, for example, address the structural problems of financial conglomerates nor effectively handle a financial crisis. It is the integrated supervisory system through which such consolidated supervision may be implemented, and thus, the structural problems of financial groups may also be more effectively monitored.

While consolidated supervision is an essential element of the stability of the financial markets, other factors should also be given due consideration. One of these factors is the issue of the authority's division within the integrated authority. Another practical issue is whether the state budget would be able to support the increased costs of such an integrated authority.

Finally, consolidated supervision should also not endanger the equal treatment of or unduly burden those entities subjected to the Act. However, as consolidated supervision applies to non-financial companies as well, if they are controlled for example by a bank, this may hinder their position on the non-financial markets to the advantage of "independent" competitors, are not owned by banks.

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